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No. 92-854

In The

Supreme Court of the United States

October Term, 1992

CENTRAL BANK OF DENVER, N.A.,

Petitioner,

vs.

FIRST INTERSTATE BANK OF DENVER, N.A. and JACK K. NABER,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit

BRIEF OF AMICUS CURIAE TRIAL LAWYERS FOR PUBLIC JUSTICE, P.C. AND UNITED STATES PUBLIC INTEREST RESEARCH GROUP IN SUPPORT OF RESPONDENTS

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QUESTIONS PRESENTED

1. Whether there is a private right of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5.

2. Whether recklessness satisfies the scienter requirement for aiding and abetting.

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I. INTRODUCTION AND INTEREST OF AMICUS CURIAE[1]

Trial Lawyers for Public Justice, P.C. (TLPJ) and United States Public Interest Research Group (USPIRG) are, respectively, a public interest law firm and a consumer advocacy organization which represent victims of fraud and misconduct. USPIRG is the national lobbying office for state Public Interest Research Groups (PIRGs) located in 31 states. State PIRGs are non-profit, non-

[1] This *amicus curiae* brief is filed pursuant to consent letters provided by counsel for Petitioner and Respondents.

partisan research and advocacy organizations with more than one million members.

The anti-fraud provisions of the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act) and rules and regulations promulgated thereunder by the Securities and Exchange Commission (SEC) are among the few effective remedies available to victims of fraud. TLPJ and USPIRG advocate continued recognition that the private right of action under § 10(b) of the Exchange Act and SEC Rule 10b-5 encompass aiding and abetting liability. This result is consistent with the Exchange Act's statutory language, construction and public policy which compelled its enactment and motivates its interpretation. Further, TLPJ and USPIRG believe that *recklessness* is the appropriate level of scienter for aiding and abetting liability and that the decision of the court below should be affirmed.[2]

II. ARGUMENT

A. Recognition Of Aiding And Abetting Liability Is Consistent With The Language Of § 10(b) And Rule 10b-5, Which Were Designed To Protect Investors And Deter Securities Fraud

" 'The starting point in every case involving construction of a statute is the language itself.' "[3] Section 10(b) and Rule 10b-5 state that it is "unlawful" for *"any person"* to engage in deceptive or manipulative acts or practices.[4] A violation of either provision is a

[2] The decision of the court below is reported as *First Interstate Bank of Denver, N.A. v. Pring*, 969 F.2d 891 (10th Cir. 1992), *cert. granted sub nom. Central Bank of Denver, N.A. v. First Interstate Bank, N.A.*, 113 S. Ct. 2927 (1993).

[3] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976) (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring)).

[4] Section 10(b) makes it "unlawful for *any person*" to use or employ "any manipulative or deceptive device or contrivance" in connection with the purchase or sale of any security and empowers the SEC to prescribe necessary and appropriate rules and regulations *"in the public interest or for the protection of investors."* 15 U.S.C. § 78j(b) (emphasis added). Rule 10b-5 makes it "unlawful for *any person*" to "employ any device, scheme, or artifice to defraud," make misleading representations or omissions, or "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person" in connection with the purchase or sale of any security. 17 C.F.R. § 240.10b-5 (emphasis added). Taken together, "[t]he sweeping words of § 10(b) and Rule 10b-5 ban manipulation, deception, or fraud in the purchase or sale of securities. '[A]ny person' who engages in such activity merits condemnation under the statute and the rule." *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 113 S. Ct. 2085, 2094 (1993) (Thomas, Blackmun and O'Connor, JJ., dissenting).

crime[5] and aider and abettor liability is recognized under the common law of tort[6] and federal criminal law,[7] where

[5] *See* 15 U.S.C. § 78ff (criminal liability for violations of securities laws); *United States v. Chiarella*, 588 F.2d 1358, 1368 n.16 (2d Cir. 1978) ("It is well-established that, except for issues of intent and burden of proof, criminal and civil liability under the securities laws are coextensive."), *rev'd on other grounds*, 445 U.S. 222 (1980).

[6] The *Restatement (Second) of Torts* § 876(b) (1979) imposes liability for harm to a third party if the person "knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself. . . . " In civil damage actions, the courts created the aiding and abetting cause of action largely by analogy to tort theories. *See, e.g., Brennan v. Midwestern Life Ins. Co.*, 259 F. Supp. 673, 680 (N.D. Ind. 1966) (noting that the *Restatement* principles "surely best fulfill the purposes of the [Exchange Act]"), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970); *see also Halberstam v. Welch*, 705 F.2d 472, 477-78, 481-86 (D.C. Cir. 1983).

[7] 18 U.S.C. § 2(a) provides that "[w]hoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal."

the roots of the § 10(b) aiding and abetting cause of action lie.[8] Under 18 U.S.C. § 2(a), aiding and abetting a violation of § 10(b) *is* a violation of § 10(b). Moreover, aiding and abetting securities fraud is precisely the kind of deceptive practice which § 10(b) was designed to prohibit.[9]

This construction is consistent with § 10(b)'s purpose to protect investors from fraudulent practices in the

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See United States v. Tejada, 956 F.2d 1256, 1265 (2d Cir.) (to convict a defendant as an aider and abettor, government need show only " 'that [a defendant] in some sort associate[d] himself with the venture, that he participate[d] in it as in something that he wish[ed] to bring about, that he [sought] by his action to make it succeed' "; conviction may be upheld "even if a defendant did not participate 'in every phase of the criminal venture,' or have a 'stake in the outcome of the illegal venture.' ") (citations omitted), *cert. denied*, 113 S. Ct. 334 (1992); *see also Nye & Nissen v. United States*, 336 U.S. 613, 619 (1949). Federal criminal aiding and abetting liability was codified 25 years before the Exchange Act was enacted, *see* Act of Mar. 4, 1909, ch. 321, § 332, 35 Stat. 1152 (formerly 18 U.S.C. § 550).

[8] *See SEC v. Seaboard Corp.*, 677 F.2d 1301, 1311 (9th Cir. 1982) ("Tort and criminal theories have supported the implication of aider and abettor . . . liability."); *accord Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1127 (5th Cir. 1988), *vacated in part on other grounds*, 492 U.S. 918 (1989); *IIT v. Cornfeld*, 619 F.2d 909, 922 & n.15 (2d Cir. 1980); *see also* 5 A. Jacobs, *The Impact of Rule 10b-5* § 2, at 1-5 (1980) ("Common law has an important bearing on [Rule] 10b-5 because courts discussing the Rule frequently analogized to tort concepts").

[9] As Petitioner concedes, *see* Brief for Pet. at 20, 18 U.S.C. § 2(a) reaches aiders and abettors of criminal violations of the securities laws. *See United States v. Kessi*, 868 F.2d 1097, 1103 (9th Cir. 1989) (affirming defendant's conviction for aiding and abetting § 10(b) violations); *United States v. Re*, 336 F.2d 306, 318 (2d Cir. 1964) (same), *cert. denied*, 379 U.S. 904 (1964); Bromberg & Lowenfels, *Aiding and Abetting Securities Fraud: A Critical Examination*, 52 Alb. L. Rev. 637, 766 (1988).

securities markets[10] and serve as "a comprehensive antifraud provision operating even when more specific laws have no application."[11] Congress' aim "in enacting the [Exchange] Act was not confined solely to compensating defrauded investors"; rather, "Congress intended to *deter fraud and manipulative practices* in the securities markets, and to ensure full disclosure of information material to invest[ors]."[12] Rules facilitating § 10(b) litigation "support[] the congressional policy embodied in the [Exchange] Act" of combating all forms of securities fraud.[13] Although Congress gave the SEC primary enforcement responsibility, private suits constitute "an essential tool for enforcement of the [Exchange] Act's requirements"[14] and are " 'a necessary supplement to

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[10] *See Basic, Inc. v. Levinson*, 485 U.S. 224, 230 (1988) ("The [Exchange] Act was designed to protect investors against manipulation of stock prices.") (citing S. Rep. No. 792, 73d Cong., 2d Sess. 1-5 (1934)).

[11] *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773, 2789 (1991) (Kennedy and O'Connor, JJ., dissenting); *see also Herman & MacLean v. Huddleston*, 459 U.S. 375, 386 (1983) (referring to "the broad proscription against fraud in § 10(b)").

[12] *Randall v. Loftsgaarden*, 478 U.S. 647, 664 (1986) (emphasis added; citations omitted); *accord Musick, Peeler & Garrett*, 113 S. Ct. at 2090; *see also Herman & MacLean v. Huddleston*, 459 U.S. at 386-87 (primary policy in Exchange Act is the punishment and deterrence of securities violations).

[13] *Basic, Inc. v. Levinson*, 485 U.S. at 245.

[14] *Id.* at 231; *see also* Frankel, *Implied Rights of Action*, 67 Va. L. Rev. 553, 556 (1981) (primary purpose behind implied remedies in the securities field has been to deter fraudulent conduct through "an extension of SEC action").

[SEC] action,' "[15] as the SEC has repeatedly acknowledged.[16]

Aiding and abetting liability is consistent with public policy underlying the federal securities laws, which were enacted in the wake of the Great Depression to prevent a repeat of the 1929 stock market crash[17] by correcting inadequacies in the information provided by securities issuers to the investing public, deterring fraud and manipulation and restoring confidence in the securities markets,[18] necessary steps suggested by President Roosevelt.[19] The Securities Act and the Exchange Act were

[15] *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) (quoting *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964)).

[16] *See* Ruder, *The Development of Legal Doctrine Through Amicus Participation: The SEC Experience*, 1989 Wis. L. Rev. 1167, 1168 (observing, as former SEC chairman, that "private securities litigation plays an essential role in federal securities regulation"); *see also Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations for 1990: Hearings Before a Subcomm. of the House Comm. on Appropriations*, 101st Cong., 1st Sess., pt. 6, at 208-09 (1989) (Statement of SEC chairman Ruder reporting that investor complaints, "which have increased significantly in recent years . . . are a traditional indicator of potential fraud. In 1987, the [SEC] received over 40,000 complaints and inquiries from investors, over 230% the number received in 1982.").

[17] *See United States v. Naftalin*, 441 U.S. 768, 775 (1979); *Ernst & Ernst v. Hochfelder*, 425 U.S. at 194.

[18] *See* 77 Cong. Rec. 2914 (1933) (remarks of Rep. Greenwood), *reprinted in* 1 J. Ellenberger & E. Mahar, *Legislative History of the Securities Act of 1933 and the Securities Exchange Act of 1934*, Item 7 (1973) (*Legislative History*); 77 Cong. Rec. 2939-40 (1934) (remarks of Rep. Koppleman), *reprinted in* 1 *Legislative History*, Item 7.

[19] In a special message to Congress, President Roosevelt called attention to the fragile state of financial institutions, stressing the need to deter securities fraud. He stated that securities legislation "should give impetus to honest dealing in securities and thereby bring back public confidence," and observed that "the public in the past has sustained severe losses through practices neither ethical nor honest on the part of many persons and corporations selling securities." 77 Cong. Rec. 937 (1933), *reprinted in* 1 *Legislative History*, Item 3.

enacted to combat securities fraud because state law was inadequate[20] to remedy the absence of business ethics on Wall Street.[21]

Professionals who seek to "reform" the securities laws and obtain immunity from liability for fraud and manipulation are direct descendants of critics in the 1930s who sought to repeal or modify the Securities Act and the Exchange Act, arguing that the legislation was so "draconian" that it would "dry up the nation's underwriting business and that 'grass would grow on Wall Street.' "[22]

[20] *See* 77 Cong. Rec. 3801 (1933) (remarks of Sen. Fletcher: Securities Act is "designed to protect the public from financial racketeering of . . . investment bankers . . . "); 77 Cong. Rec. 2914 (1933), *reprinted in* 1 *Legislative History*, Item 7 (remarks of Rep. Mapes: "[M]any of the leading bankers in the country no longer have the old-time sense of ethics or [pay] attention to the strict detail of honest business like the bankers of a former day. . . . The sale of . . . securities has reached a point where it is a scandal and a gigantic racket in America, and the Federal Government is the agency to stop it.").

[21] *See United States v. Naftalin*, 441 U.S. at 775-76; *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186-87 (1963); 77 Cong. Rec. 2925 (1933) (remarks of Rep. Kelly: "honest and legitimate industry . . . has been . . . made the victim of greedy and ruthless investment bankers"), *reprinted in* 1 *Legislative History*, Item 7; R. Jennings & H. Marsh, *Securities Regulation* 23 (5th ed. 1982) (*Securities Regulation*) (same).

[22] D. Ratner, *Securities Regulation* § 11, at 80 (2d ed. 1982). Justice Felix Frankfurter, then a professor and one of the leading spokesmen for the Securities Act, wrote that "[t]he leading financial law firms who have been systematically carrying on a campaign against [the Securities Act] have been seeking – now

These statutes targeted errant professionals, who were properly held responsible for the celebrated excesses of the 1920s,[23] and they encountered both open and undercover resistance.[24] In the end, Congress passed President

that they and their financial clients have come out of their storm cellar of fear – not to improve but to chloroform the Act. They evidently assume that the public is unaware of the sources of the issues that represent the boldest abuses of fiduciary responsibility. . . . " J. Seligman, *The Transformation of Wall Street* 79 (1983) (*Transformation*) (quoting letter from Felix Frankfurter to Henry Stimson (Dec. 19, 1933)).

[23] Professor James Landis, the leading historian of the federal securities laws, has written that the Securities Act "naturally had its beginnings in the high financing of the Twenties that was followed by the market crash of 1929" and the "spectacularly illuminating investigation of the nature of this financing" undertaken by the Senate Banking and Currency Committee under the direction of counsel Ferdinand D. Pecora. "The Committee spread on the record more than the peccadillos of groups of men involved in the issuance and marketing of securities. It indicted a system as a whole that had failed miserably in imposing those essential fiduciary standards that should govern persons whose function it was to handle other people's money. Investment bankers, brokers and dealers, corporate directors, accountants, all found themselves the subject of criticism so severe that the American public lost much of its faith in professions that had theretofore been regarded with respect that had approached awe." Landis, *The Legislative History of the Securities Act of 1933*, 28 Geo. Wash. L. Rev. 29, 30 (1959) (*Securities Act*).

[24] Richard Whitney, president of the New York Stock Exchange, led the well-supported fight against securities regulation by the Government. He viewed such legislation as indirectly constituting a nationalization of business, which might result in a freezing of the stock exchange. *See* J. Seligman, *Transformation*, at 90. In addition, George May of Price Waterhouse & Co. was "opposed to . . . requirements for independent accountants." Landis, *Securities Act*, 28 Geo. Wash. L. Rev. at 35 n.12.

Roosevelt's legislation, including the Exchange Act, which entrusted authority over the market to the SEC.[25]

Abuses of the securities markets which led to enactment of these statutes have not disappeared with the passage of time,[26] and the Exchange Act cannot be subverted to provide errant professionals with a safe haven from primary *or* secondary liability to defrauded investors. For more than forty years, the federal courts have held that recognition of a private right of action for aiding and abetting securities fraud is necessary[27] if

[25] *See* Note, *"Controlling" Securities Fraud: Proposed Liability Standards for Controlling Persons Under the 1933 and 1934 Securities Acts*, 72 Minn. L. Rev. 930, 930 n.2 (1988) ("The [Exchange] Act was adopted to regulate the securities markets, to provide a disclosure method to the people buying and selling securities, to create remedies for fraud, and to control the amount of the nation's credit being put into the securities market.") (citation omitted).

[26] Those who seek to abolish aiding and abetting liability distort the meaning of Congressional inaction more than three decades ago, *see* Brief for Pet. at 20-22; Brief *Amicus Curiae* of the Sec. Indus. Ass'n at 15-16, ignoring a 1983 Congressional report which, prior to passage of the Insider Trading Sanctions Act of 1984, Pub. L. 98-376, expressly endorsed "the judicial application of aiding and abetting liability to achieve the remedial purposes of the securities laws." H.R. Rep. No. 355, 98th Cong., 1st Sess. at 10 (1983), *reprinted in* 1984 U.S.C.C.A.N. 2274, 2283.

[27] Petitioner's *amici* improperly refer to aiding and abetting § 10(b) violations as a "new" cause of action, *see, e.g.*, Brief *Amicus Curiae* of the Sec. Indus. Ass'n at 4, 10 and 17, ignoring the fact that aiding and abetting liability does *not* create a separate offense, *see Ruthenberg v. United States*, 245 U.S. 478, 481, 483 (1918); *United States v. Sellers*, 871 F.2d 1019, 1022 (11th Cir. 1989), the wealth of precedent recognizing such liability under the Exchange Act. *See* nn. 29-34, *infra*. The aiding and abetting cause of action repeatedly recognized by the federal courts is no more "new" than the § 10(b) defendant's claim for contribution reaffirmed by this Court in *Musick, Peeler & Garrett*, 113 S. Ct. at 2091.

defrauded investors are to be made whole and fraud and manipulation are to be deterred. This case provides no basis to change well-settled law.

B. Recognition Of A Private Right Of Action For Aiding And Abetting Promotes The Essential Public Interests Underlying The Exchange Act

Although this Court has twice reserved decision on aiding and abetting liability,[28] it should not ignore the federal courts' repeated recognition of this private right of action. Numerous early decisions recognized aiding and abetting[29] liability,[30] while each circuit court has

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[28] In *Ernst & Ernst v. Hochfelder*, 425 U.S. at 191-92 n.7, this Court stated that "[i]n view of our holding that an intent to deceive, manipulate, or defraud is required for civil liability under § 10(b) and Rule 10b-5, we need not consider whether civil liability for aiding and abetting is appropriate under the section and the Rule, nor the elements necessary to establish such a cause of action." *See also Herman & MacLean v. Huddleston*, 459 U.S. at 379 n.5.

[29] *See, e.g., Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. at 676-81 (issuer knowingly and purposely encouraged an artificial build-up in the market for its stock by failing to report improper activities of brok[illegible] firm, which failed to deliver issuer's stock to purchas[illegible] *American Stock Exchange*, 217 F. Supp. 21, 28 (S.D[illegible] holding claims alleging that stock exchange an[illegible] and abetted an illegal distribution of stock "by [illegible] ary disciplinary action" against brokers who [illegible] ld have known were engaged in abusive conduct [illegible] well as allegations that other defendants, inclu[illegible] wed principal violators to open and maintain [illegible] nts); *Fry v. Schumacher*, 83 F. Supp. 476, 478 (E.D[illegible] refusing to dismiss claim against brokers who had [illegible] by principal violators to write a letter which was a[illegible] part of the plan to defraud).

[30] Even before the implie[illegible] right of action under § 10(b) was recognized in *Ka*[illegible] *Gypsum Co.*, 69 F.

recognized a private right of action for aiding and abetting under § 10(b) and Rule 10b-5.[31] This unanimous

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Supp. 512, 514 (E.D. Pa. 1946), liability for aiding and abetting § 10(b) violations was employed in SEC enforcement actions. *See* Note, *A Complicity-Doctrine Approach to Section 10(b) Aiding and Abetting Civil Damages Actions*, 89 Colum. L. Rev. 180, 181 (1989). In *SEC v. Timetrust, Inc.*, 28 F. Supp. 34 (N.D. Cal. 1939), a suit seeking an injunction against principal violators and aiders and abettors, the district court upheld the SEC's complaint against the latter, citing the criminal code provisions making aiders and abettors responsible as principals and stating, "[N]o good reason appears why this same rule should not apply in an injunctive proceeding to restrain a violation of the same statute." *Id.* at 43. The court commented that "[t]here is ample authority to support the validity of a suit to enjoin persons who are aiding and abetting the commission of unlawful acts." *Id.* Petitioner's *amici* inexplicably ignore these early precedents. *See* Brief *Amicus Curiae* of the Sec. Indus. Ass'n at 7, 13.

[31] *See, e.g., Bloor v. Carro, Spanbock, Londin, Rodman & Fass*, 754 F.2d 57, 62 (2d Cir. 1985); *Hirsch v. Du Pont*, 553 F.2d 750, 758 (2d Cir. 1977); *Gould v. American-Hawaiian S.S. Co.*, 535 F.2d 761, 779-80 (3d Cir. 1976); *Abell v. Potomac Ins. Co.*, 858 F.2d at 1126 ("[O]ur [Fifth Circuit] cases impose [§]10b-5 [sic] liability upon those who abet securities fraud.") (citing *Woodward v. Metro Bank*, 522 F.2d 84 (5th Cir. 1975)); *Herm v. Stafford*, 663 F.2d 669, 684 (6th Cir. 1981); *Ackerman v. Schwartz*, 947 F.2d 841, 845-46 (7th Cir. 1991); *FDIC v. First Interstate Bank, N.A.*, 885 F.2d 423, 429 (8th Cir. 1989); *SEC v. Seaboard Corp.*, 677 F.2d at 1311; *Kerbs v. Fall River Indus., Inc.*, 502 F.2d 731, 740 (10th Cir. 1974); *Investors Research Corp. v. SEC*, 628 F.2d 168, 178 (D.C. Cir.), *cert. denied*, 449 U.S. 919 (1980). *See generally* 4 A. Bromberg & L. Lowenfels, *Securities Fraud & Commodities Fraud*, § 8.5(610), at 8:505 (1991); Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification and Contribution*, 120 U. Pa. L. Rev. 597, 627-38 (1972) (*Multiple Defendants*).

precedent accords with the express language, statutory framework[32] and purposes of the Exchange Act:

> [A] statute with a broad and remedial purpose such as the [Exchange Act] should not easily be rendered impotent to deal with new and unique situations within the scope of the evils intended to be eliminated. In the absence of a clear legislative expression to the contrary, the statute must be flexibly applied so as to implement its policies and purposes. In this regard, it cannot be said that civil liability for damages, so well established under the [Exchange Act], may never under any circumstances be imposed upon persons who do no more than aid and abet a violation of [§]10(b) and Rule 10b-5.[33]

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[32] In *Musick, Peeler & Garrett*, this Court recognized that §§ 9 and 18 of the Exchange Act, 15 U.S.C. § 78i and § 78r, are particularly "close in structure, purpose and intent to the 10b-5 action," 113 S. Ct. at 2090 (citation omitted), and stated that interpreting a Rule 10b-5 action consistently with §§ 9 and 18 is important "to ensure the [10b-5] action does not conflict with Congress' own express rights of action, to promote clarity, consistency and coherence for those who rely upon or are subject to 10b-5 liability, and to effect Congress' objectives in enacting the securities laws." *Id.* (citations omitted). Contrary to Petitioner's assertion, *see* Brief for Pet. at 10; *see also* Brief of AICPA as *Amicus Curiae* at 4, 13-15, the SEC interprets § 9 to extend liability to aiders and abettors, *see In re Barry L. Lefko*, 47 S.E.C. 373 (Sept. 30, 1980), while accountants have been held liable as aiders and abettors under § 18, *see, e.g., In re Equity Funding Corp. of Amer. Sec. Litig.*, 416 F. Supp. 161, 190-91 (C.D. Cal. 1976).

[33] *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. at 680-81. *See also* Note, *Liability for Aiding and Abetting Violations of Rule 10b-5: The Recklessness Standard in Civil Damage Actions*, 62 Tex. L. Rev. 1087, 1093 (1984) (*Recklessness Standard*).

Common law aiding and abetting liability was well established when the Exchange Act was enacted,[34] and this Court has stated that Rule 10b-5 actions "are in part designed *to add to the protections provided investors by the common law*."[35] Thus, federal courts' unanimous recognition of aiding and abetting claims, developed over decades of litigation and securities fraud schemes of every sort, should not be ignored by this Court.[36]

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[34] *See* Ruder, *Multiple Defendants*, 120 U. Pa. L. Rev. at 620; Kuehnle, *Secondary Liability Under the Federal Securities Laws – Aiding and Abetting, Conspiracy, Controlling Person, and Agency: Common-Law Principles and the Statutory Scheme*, 1988 J. Corp. L. 313, 316-17.

[35] *Basic, Inc. v. Levinson*, 485 U.S. at 244 n.22 (citing *Herman & MacLean v. Huddleston*, 459 U.S. at 388-89 ("[A]n important purpose of the federal securities statutes was to rectify perceived deficiencies in the available common-law protections. . . . ")).

[36] Just this past Term, when this Court recognized a defendant's right to seek contribution in a Rule 10b-5 private action, Justice Kennedy stated that "[o]ur conclusion is consistent with the rule adopted by the vast majority of courts of appeals and district courts that have considered the question," observing that "[w]e consider this to be of particular importance because in the more than twenty years since a right to contribution was first recognized for 10b-5 defendants, neither the [SEC] nor the federal courts have suggested that the contribution right detracts from the effectiveness of the 10b-5 implied action or interferes with the effective operation of the securities laws." *Musick, Peeler & Garrett*, 113 S. Ct. at 2091 (citations omitted). This recent teaching is equally applicable here. *See Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1123 (7th Cir. 1990) (recognizing that "aider and abettor liability is rooted in 20+ years' precedent"), *cert. denied*, 111 S. Ct. 1317 (1991); Ferrara & Sanger, *Derivative Liability in Securities Law: Controlling Person Liability, Respondeat Superior, and Aiding and Abetting*, 40 Wash. & Lee L. Rev. 1007, 1023 (1983).

C. The Recklessness Standard Of Scienter Should Govern Aiding And Abetting Liability

This Court has held that a finding of *scienter* – intent to deceive, manipulate, or defraud – is a prerequisite to § 10(b) liability, eliminating negligence as a possible basis for a finding of liability, but not deciding whether *recklessness* could be sufficient.[37] The circuit courts unanimously agree that *recklessness* satisfies the scienter requirement.[38] Given this precedent, common law recognition that *reckless* behavior supports fraud claims,[39] and

[37] In *Ernst & Ernst v. Hochfelder*, 425 U.S. at 194 n.12, this Court defined scienter as "a mental state embracing intent to deceive, manipulate, or defraud," and adopted the view that the language of § 10(b), in particular the terms "manipulative," "device" and "contrivance" revealed an unambiguous intent on the part of Congress to proscribe only "knowing or intentional practices." *Id.* at 197-99; *see also Aaron v. SEC*, 446 U.S. 680, 690 (1980).

[38] *See, e.g., Cook v. Avien, Inc.*, 573 F.2d 685, 692 (1st Cir. 1978); *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 46 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978); *Sharp v. Coopers & Lybrand*, 649 F.2d 175, 193 (3d Cir. 1981), *cert. denied*, 455 U.S. 938 (1982); *Broad v. Rockwell Int'l Corp.*, 642 F.2d 929, 961-62 (5th Cir.) (en banc), *cert. denied*, 454 U.S. 965 (1981); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1024 (6th Cir. 1979); *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1044 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977); *Stokes v. Lokken*, 644 F.2d 779, 783 (8th Cir. 1981); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568-69 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 1621 (1991); *Hackbart v. Holmes*, 675 F.2d 1114, 1117-18 (10th Cir. 1982); *Woods v. Barnett Bank*, 765 F.2d 1004, 1010 (11th Cir. 1985); *Dirks v. SEC*, 681 F.2d 824, 844 & n.27 (D.C. Cir. 1982), *rev'd on other grounds*, 463 U.S. 646 (1983). *See also* Note, *Recklessness Standard*, 62 Tex. L. Rev. at 1100-02.

[39] *Hochfelder* acknowledged that "[i]n certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act." 425 U.S. at 194 n.12. At common law, *recklessness* sufficed to establish civil liability for fraud and deceit. *See, e.g., Cooper v. Schlesinger*, 111

the fact that *recklessness* suffices for *criminal* liability,[40] this standard suffices to prove aiding and abetting. Because

U.S. 148, 155 (1884); *cf. Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749, 2759 (1991); *see also Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d at 1044; *Derry v. Peek*, 14 App. Cas. 337, 374 (1889) (per Lord Herschell) ("[F]raud is proved when it is shewn that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) *recklessly*, careless whether it be true or false."); Freeman & Crystal, *Scienter in Professional Liability Cases*, 42 S.C. L. Rev. 783, 788-93 (1991); W. Page Keeton, *et al.*, *Prosser & Keeton on the Law of Torts*, § 107, at 741-42 (5th ed. 1984); *Restatement (2d) of Torts*, § 526, comment e (1977). *Sundstrand* stated that "[s]ince there is no hint in *Hochfelder* that the [Supreme] Court intended a radical departure from accepted Rule 10b-5 principles, it would be highly inappropriate to construe the Rule 10b-5 remedy to be more restrictive in substantive scope than its common law analogs." 553 F.2d at 1044 (footnotes omitted).

[40] *See* 18 U.S.C. § 1341 (mail fraud); *United States v. Gay*, 967 F.2d 322, 326 (9th Cir.) ("We have repeatedly held that reckless indifference alone will support a mail fraud conviction.") (citations omitted), *cert. denied*, 113 S. Ct. 359 (1992). Both lawyers and accountants have been found guilty of criminal violations under a recklessness culpability standard. *See, e.g., United States v. Frank*, 520 F.2d 1287 (2d Cir. 1975) (conviction of lawyer for conspiracy to violate securities laws in connection with public offering), *cert. denied*, 423 U.S. 1087 (1976); *United States v. Simon*, 425 F.2d 796 (2d Cir. 1969) (accountants convicted for issuing audit opinion in violation of mail fraud and false statement statute and securities laws), *cert. denied*, 397 U.S. 1006 (1970). Trial judges approve instructions that allow juries to infer willful and knowing criminal securities law violations based on defendant auditors' "reckless deliberate indifference to or disregard for truth or falsity." *United States v. Weiner*, 578 F.2d 757, 786, 787 (9th Cir.), *cert. denied*, 439 U.S. 981 (1978); *United States v. Natelli*, 527 F.2d 311, 322-23 (2d Cir. 1975), *cert. denied*, 425 U.S. 934 (1976).

this Court should interpret § 10(b) to protect investors,[41] uniform application of the recklessness standard[42] would acknowledge pivotal roles played by lawyers, accountants, investment bankers and brokers in effective implementation of the securities laws[43] and ensure at least

[41] *See Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972); Aldave, *"Neither Unusual nor Unfortunate": The Overlap of Rule 10b-5 with the Express Liability Sections of the Securities Acts*, 60 Tex. L. Rev. 714, 755 (1982).

[42] "Nothing in *Hochfelder* or in any other Supreme Court decision suggests that the scienter requirement should differ for primary violators and aiders and abettors." Note, *Recklessness Standard*, 62 Tex. L. Rev. at 1111 (footnote omitted). Indeed, in *United States v. Feola*, 420 U.S. 684, 686-88 (1975), this Court rejected the notion that connivers enjoy a heightened intent standard compared to primary wrongdoers.

[43] *See In re American Continental Corp./Lincoln Sav. & Loan Sec. Litig.*, 794 F. Supp. 1424, 1441-54 (D. Ariz. 1992) (*ACC/Lincoln*) (detailing roles played by accounting firms, law firms and consulting firms in multi-billion dollar fraudulent scheme to defraud over 20,000 elderly investors); *Mishkin v. Peat, Marwick, Mitchell & Co.*, 658 F. Supp. 271, 273-75 (S.D.N.Y. 1987) (detailing integral role played by accountants in securities regulatory process); Note, *Establishment of Liability for Aiding and Abetting Fraud Under Rule 10b-5 and the Common Law*, 25 UCLA L. Rev. 862, 883-84 (1978) (same).

minimal diligence by such participants,[44] thus enhancing protection afforded investors.[45]

D. Given The Prevalence Of Fraud And White-Collar Crime, This Court Should Be Loath To Restrict Remedies Available To Innocent Victims

Our societal landscape is littered with the wreckage of costly failures of financial institutions, many of which have been caused by fraudulent and criminal activity and the costs of which are incalculable.[46] The past three

[44] Accountants themselves do not dispute or disclaim their obligation to third party users of audit opinions: "A distinguishing mark of a profession is acceptance of its responsibility to the public. The accounting profession's public consists of clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of certified public accountants to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on certified public accountants." 2 AICPA, *Professional Standards*, § 53.01 (CCH 1988).

[45] Holding errant professionals liable for recklessness furthers the underlying goal of the securities laws, which is to encourage investment. An investor's willingness to invest is largely dependent on his or her trust and confidence that capital and proceeds will not be abused. *See* Langevoort, *Fraud and Deception by Securities Professionals*, 61 Tex. L. Rev. 1247, 1275 (1983). By requiring that experts and insiders at least avoid the extreme conduct proscribed by the recklessness standard, the securities laws enhance investor trust. Note, *Recklessness Standard*, 62 Tex. L. Rev. at 1113.

[46] The financial costs incurred by society as a result of fraudulent activity and so-called "white collar" crime are enormous. *See generally* J. Cotchett & S. Pizzo, *The Ethics Gap* (1991). In 1974, the U.S. Chamber of Commerce estimated the direct economic cost of fraud as $41.78 billion annually. Chamber of Commerce of the U.S., *A Handbook on White Collar Crime: Everyone's Problem, Everyone's Loss* 6 (1974). A decade later, the Attor-

decades have witnessed numerous financial scandals resulting in multi-billion dollar losses to innocent investors (including stockholders, bondholders and depositors) in financial institutions and corporate entities for which errant professionals bear a large degree of responsibility.[47] These scandals include Bank of Credit and Commerce International (BCCI), whose worldwide criminality and resulting 1991 collapse and seizure by regulators caused one million depositors to lose $8-10 billion,[48]

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ney General observed that white collar crime, principally fraud, costs nearly $200 billion annually. 1985 Atty. Gen. Ann. Rep. 42; *see also White Collar Crime: Hearings Before the Senate Comm. on the Judiciary*, 99th Cong., 2d Sess., Parts I-III (1985). That now-dated annual loss figure is similar in dimensions to our drug problem, which is most often described as an epidemic. *See Drug Enforcement: Hearing on H.R. 526 Before Subcomm. on Crime of the House Comm. on the Judiciary*, 99th Cong., 2d Sess. (1986) (Remarks of Rep. Hughes: $110 billion spent annually on drugs while lost productivity costs approximately $60 billion).

[47] A recent report provides eleven case studies of litigation involving the so-called "Big Six" accounting firms (KPMG Peat Marwick, Ernst & Young, Coopers & Lybrand, Arthur Andersen, Deloitte & Touche and Price Waterhouse) illustrating flagrant deficiencies leading to large-scale failures and consumer losses. In just six of these examples, shareholders, investors, creditors and/or taxpayers lost more than $10 *billion*: Benjamin Franklin Sav. Ass'n – $976 million (Arthur Andersen); MiniScribe Corp. – $20.5 million for bondholders alone (Coopers & Lybrand); CenTrust Sav. Bank – $1.8 billion (Deloitte & Touche); Vernon Sav. & Loan Ass'n, Silverado Sav. & Loan Ass'n, Lincoln Sav. & Loan Ass'n and Western Sav. & Loan Ass'n – $6.6 billion (Ernst & Young); Hill Finan. Sav. Ass'n – $988 million (KPMG Peat Marwick); and United Bank of Arizona – $338 million (Price Waterhouse). *See* Public Citizen/USPIRG, *Bad Audits . . . Not Deep Pockets: Illustrations of Failed Audits by the Big 6* 7-8 (1993).

[48] Depositors, including U.S. citizens and residents, were induced to place their money in the BCCI Banks, where it was used to finance illegal transactions, siphoned off to BCCI insiders and affiliates, and lost forever when the Banks were seized by regulators. Because BCCI was headquartered in so-called "secrecy" jurisdictions where deposit insurance is virtually non-existent, defrauded depositors may recover only a fraction of their losses. BCCI pled guilty to state and federal criminal charges arising from its illegal conduct in the U.S. and agreed to forfeit over $550 million in assets located here. Numerous professionals, including accounting firms (Price Waterhouse and Ernst & Young), allegedly aided and abetted BCCI in its lengthy effort to defraud depositors and deceive banking regulators, as detailed in the two-volume U.S. Senate investigative report, Subcommittee on Terrorism, Narcotics and International Operations, *The BCCI Affair: A Report to the Senate Comm. on Foreign Relations* (1992), and the report published by the General Accounting Office (GAO), *Foreign Bank – Initial Assessment of Certain BCCI Activities in the U.S.* (1992).

and the celebrated downfall of Charles Keating's American Continental Corporation (ACC) and wholly-owned Lincoln Savings (Lincoln), whose 1989 bankruptcy and seizure by federal regulators cost taxpayers over $2 billion.[49] Scandals also enveloped once-respectable financial

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[49] The Federal Deposit Insurance Corporation (FDIC), Resolution Trust Corporation (RTC) and defrauded bondholders brought civil actions against Keating, insiders and professional advisers who assisted in carrying out an elaborate securities and bank fraud scheme. Keating utilized political influence to stave off regulatory censure and seizure of Lincoln by improperly influencing members of Congress (including the "Keating Five") and intimidating regulators while he peddled worthless junk bonds in thrift branch offices to elderly victims who thought they were purchasing government-insured bonds. The *ACC/Lincoln* class action, which targeted three of the "Big Six" accounting firms (Arthur Andersen, Arthur Young and Touche Ross) and three national law firms (Sidley & Austin, Kaye Scholer Fierman Hays & Handler, and Jones Day Reavis & Pogue) who aided and abetted Keating in violating federal and state securities laws, defrauding innocent investors and intimidating federal and state regulators resulted in settlements totaling $250 million paid by errant professionals and, following a three-month jury trial, a jury verdict of $3.3 billion against

institutions and financiers, such as Drexel Burnham Lambert and Michael Milken,[50] as well as other Wall Street investment banks and brokerage houses,[51] while fraud

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Keating and others. *See* M. Freudenheim, *U.S. Jury Awards $3.3 Billion To Investors From Keating*, N.Y. Times, July 11, 1992, at 15. This salutary result in a Rule 23 securities fraud class action contradicts arguments regarding the merits of such litigation raised by errant professionals. *See* Brief *Amicus Curiae* of the Sec. Indus. Ass'n at 26; Brief of AICPA as *Amicus Curiae* at 28-29.

[50] Milken was indicted on 98 counts of RICO and criminal securities fraud, pled guilty to six felony charges (including conspiracy, securities fraud, mail fraud and filing false tax returns) and was sentenced to ten years' imprisonment. *See "Junk Bond" Leader Is Indicted by U.S. in Criminal Action*, N.Y. Times, Mar. 30, 1989, at A1, col. 6 (98-count indictment); *SEC v. Milken*, [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,200 (S.D.N.Y. Apr. 24, 1990) (settlement of civil enforcement action); *United States v. Milken*, 759 F. Supp. 109 (S.D.N.Y. 1990) (*Fatico* hearing); *see also In re The Drexel Burnham Lambert Group, Inc.*, No. 92-5032, 1993 U.S. App. LEXIS 12445, at *3-*4 (2d Cir. 1993) (detailing Milken's wrongdoing).

[51] The insider trading scandals which rocked Wall Street trapped E.F. Hutton, which acknowledged systemic criminal behavior, *see White Collar Crime (E.F. Hutton): Hearings Before the Senate Judiciary Committee*, 98th Cong., 2d Sess. 132 (1986) (Sen. Jos. R. Biden: "Where I come from that is called 'theft.' " Robert Foman, chairman of E. F. Hutton Group, Inc.: "It is probably not different"). Insider trading apparently continues unabated. A recent study published by the University of Michigan's School of Business Administration "shows that top executives at troubled, publicly traded companies often begin dumping large amounts of shares as much as two years before filing for corporate bankruptcy," while "during the two years leading up to a bankruptcy filing, shareholders lose on average 75% of their investments." W. Getler, *Insiders Often Dump Shares Long Before Concerns Enter Bankruptcy, Study Says*, Wall St. J., July 7, 1993, at A5, col. 1.

and criminality infected the savings and loan industry.[52] The costs to our society and resulting loss of investor confidence cannot be calculated.

If history teaches us anything,[53] the overwhelming presence of fraud in the securities markets leading to enactment of the Securities Act and the Exchange Act has

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[52] Numerous lawsuits have been brought by the RTC, creditors and innocent investors against owners, operators, insiders and professional advisers of thrift institutions which failed as a result of insider abuse, fraudulent transactions and excessive "direct" investments, including purchase of billions of dollars of "junk bonds" peddled by Drexel/Milken. *See* Note, *Insider Abuse and Criminal Misconduct in Financial Institutions: A Crisis?*, 64 Notre Dame L. Rev. 222 (1989). The GAO studied 184 FDIC-insured banks that closed in 1987 and found that 64% of the failed banks revealed insider abuse and 38% revealed insider fraud. *Examination and Supervision of Depository Institutions: Hearings Before the House Comm. on Banking, Finance and Urban Affairs*, 101st Cong., 1st Sess. 21 (1989). Other Government studies concluded that at least one-third of bank failures and three-quarters of thrift failures involved the criminal activity of insiders. *See* Office of Comptroller of Currency, *Bank Failure: An Evaluation of the Factors Contributing to the Failure of National Banks* 9 (1988).

[53] The pervasiveness of criminal and fraudulent activity, including professionals' fiduciary breaches, was noted more than 25 years ago. *See* President's Commission on Law Enforcement and Administration of Justice, *The Challenge of Crime in a Free Society* 33-34, 47-48 (1967) (*The Challenge of Crime*) ("Fraud is especially vicious when it attacks, as it so often does, the poor or those who live on the margin of poverty. Expensive nostrums for incurable diseases, home improvement frauds, frauds involving the sale or repair of cars and other criminal schemes creates losses which are not only sizeable in gross but are also significant and possibly devastating for individual victims."); H. Edelhertz, *The Nature, Impact and Prosecution of White-Collar Crime* 9 (1970) (white-collar crime has a "serious influence on the social fabric, and on the freedom of commercial and interpersonal transactions").

not abated; if anything, the crisis has deepened.[54] The recent abuse of the securities markets makes clear that elimination of aiding and abetting liability would be especially damaging to innocent victims of fraud. Recent financial scandals are noteworthy because of the integral role played by errant professionals who aided and abetted those wrongdoers whom Theodore Roosevelt once referred to as "the wealthy criminal class."[55]

Prosecutorial resources are inadequate to combat "white-collar" crime and fraud, primary wrongdoers are often insolvent or bankrupt when the fraud is discovered,[56] and state law remedies do not provide meaningful

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[54] The Chief Justice has stated that "[w]hite-collar crime is 'the most serious and all-pervasive crime problem in America today,' " *Braswell v. United States*, 487 U.S. 99, 115 n.9 (1988) (quoting Conyers, *Corporate and White-Collar Crime: A View by the Chairman of the House Subcommittee on Crime*, 17 Am. Crim. L. Rev. 287, 288 (1980)), adding that "[a]lthough this statement was made [by Representative Conyers] in 1980, there is no reason to think the problem has diminished in the meantime." *Id.*

[55] In March 1883, supporting a bill in the New York Assembly to limit the extortionate profits earned by robber barons from operation of the Manhattan Elevated Railroad, Roosevelt stated that "[t]hey are common thieves . . . they belong to that most dangerous of all classes, the wealthy criminal class." E. Morris, *The Rise of Theodore Roosevelt* 193 (Ballantine ed. 1979); *see also* II M. Sullivan, *Our Times: The United States – America Finding Herself* 386 (1927).

[56] *See* Note, *Recklessness Standard*, 62 Tex. L. Rev. at 1088; R. Jennings & H. Marsh, *Securities Regulation*, at 1134. This was typified in the *ACC/Lincoln* case where Keating's profligate spending and Government enforcement/forfeiture proceedings had rendered him judgment-proof, his holding company (ACC) filed for bankruptcy, its wholly-owned thrift (Lincoln) was seized by regulators and ACC's insurance policies excluded coverage for investors' claims, *see Keating v. National Union Fire Ins. Co.*, No. 90-56265, 1993 U.S. App. LEXIS 12998 (9th Cir. 1993). Without securities fraud aiding and abetting claims against professionals who helped Keating cheat investors, his

remedies to victims of sophisticated financial frauds.[57] Thus, any decision impeding victims' rights against those who aid and abet § 10(b) violations would be inconsistent with express purposes of the Exchange Act.

23,000 elderly victims, many of whom lost their life's savings, would have recovered *nothing*.

[57] The notion advanced by Petitioner's *amici* that common law fraud and negligent misrepresentation claims may be brought by defrauded investors against professionals, *see* Brief of AICPA at 19-20, is misplaced. *See Gaffin v. Teledyne, Inc.*, 611 A.2d 467, 474 (Del. 1992) ("A class action may not be maintained in a purely common law or equitable fraud case since individual questions of law or fact, particularly as to the element of justifiable reliance, will inevitably predominate over common questions of law or fact.") (footnote and citations omitted). In *Basic, Inc. v. Levinson*, 485 U.S. at 241-42, this Court quoted with approval the Third Circuit's decision in *Peil v. Speiser*, 806 F.2d 1154, 1160-61 (3d Cir. 1986), recognizing the fraud-on-the-market theory for § 10(b) claims. In *Peil*, however, the Third Circuit also stated: "While the fraud on the market theory is good law with respect to the Securities Acts, no state courts have adopted the theory, and thus direct reliance remains a requirement of a common law securities fraud claim." *Id.* at 1163 n.17. *See also Bily v. Arthur Young & Co.*, 3 Cal. 4th 370, 11 Cal. Rptr. 2d 51, 834 P.2d 745 (1992) (auditor can be held liable for negligence in conducting an audit of financial statements only to person or entity contracting for auditor's services); *Mirkin v. Wasserman*, 12 Cal. App. 4th 927, 278 Cal. Rptr. 729 (fraud-on-the-market theory inapplicable to investors' claims for fraud and negligent misrepresentation), *review granted*, 1991 Cal. LEXIS 2850, 282 Cal. Rptr. 840, 811 P.2d 1024 (1991).

E. Because Errant Professionals Often Play An Integral Role In Schemes To Defraud Investors, They Should Not Be Absolved Of Aiding And Abetting Liability

Recent complex financial schemes demonstrate that errant professionals often play an integral role[58] in their conception and execution.[59] Our na[illegible] [illegible]tinuing bank and thrift crisis, which has alre[illegible] [illegible]ayers billions of dollars, was typified by a[illegible] professional

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[58] In contending tha[illegible] aiding and abetting tort liability is inapplicab[illegible] [illegible]ci cite *Blue Chip Stamps*, where this Co[illegible] [illegible]ical fact situation in which the classic [illegible]rt [illegible]on and deceit evolved was light years [illegible]d of commercial transactions to which Ru[illegible] [illegible]able." 421 U.S. at 744-45. Brief of AICPA as *A*[illegible] at 16. As Petitioner acknowledges, however, § 10(b) [illegible]ntended to enable the SEC " 'to deal with new manipulative [or cunning] devices.' " *Hochfelder*, 425 U.S. at 203 (citation omitted). *See* Brief for Pet. at 14. Recent financial schemes demonstrate the multitude of innovative ways errant professionals have developed to aid and abet crooked financiers. *See ACC/Lincoln*, 794 F. Supp at 1441-54. This trend supports *expansion* of aiding and abetting liability, *not* its elimination.

[59] *See Statement of Prof. Arthur R. Miller On H.R. 3185 Before the Subcomm. on Telecommunications and Finance, House Comm. on Energy and Commerce* at 10 (Nov. 21, 1991) ("The perpetration of a complex financial fraud is impossible without the active assistance of professionals such as investment bankers, lawyers, and accountants who must be held accountable."). Contrary to the assertions of Petitioner's *amici*, there is no reasoned basis to conclude that professionals are "routinely sued for aiding and abetting" § 10(b) violations, *see* Brief of AICPA at 2; nor is there is any basis to conclude that securities fraud claims leveled against professionals lack merit, or that they have been compelled to pay settlements that are disproportionate to their liability, *see id.* at 17-19.

ethics by accountants, lawyers and other professionals.[60] Government agencies have been sharply critical of the accounting profession for its repeated failure to uncover widespread fraud in failing financial institutions,[61] as

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[60] In assessing the causes of the thrift crisis, careful attention must be paid to critical roles played by professionals – attorneys, accountants, brokers, investment bankers, consultants and real estate appraisers – who abandoned their professional ethics to serve thrifts' operators. Crimes in thrifts "often required the cooperation of groups of people," including outside professional advisers, in what might be called a "chain of greed." The chains involved five kinds of professionals, in addition to the borrowers who benefitted from the questionable loans: "At the beginning of a transaction, *real estate brokers* masterminded the shaky deals. Crooked *appraisers* then inflated real estate values to make the deals work. Inside the institutions, an array of *employees* from loan officers hungry for a loan commission to the executives themselves participated in the fraud. At the conclusion of the deal, *lawyers* 'papered' the bogus transactions by drawing up the contracts, and *accountants* either looked the other way or neglected to scour the institutions' books too carefully." Harris, *The S&L Looters Who May Get Away*, Wall St. J., Feb. 12, 1990, at A12, col. 3.

[61] Running through the thrift crisis is the problem of fraudulent financial reporting. When such aberrant behavior occurs, widespread consequences result, sometimes causing a devastating ripple effect. *See* Nat'l Comm'n on Fraudulent Financial Reporting, *Report of the Nat'l Commission on Fraudulent Financial Reporting* 4 (1987). The GAO has excoriated the accounting profession – especially Ernst & Young – for its failing thrifts. *See* GAO, *CPA Audit Quality: Failures of CPA Audits to Identify and Report Significant Savings and Loan Problems* 1 (1989) (concluding that accountants followed improper auditing procedures in 6 out of 11 failed institutions they reviewed: "The latest audit reports for the 11 S&Ls before they failed showed combined positive net worth totaling approximately $44 million. At the time of the S&Ls' failures, which ranged from 5 to 17 months after the date of the last audit reports, the 11 S&Ls had combined negative net worth totaling approximately $1.5 billion.").

have federal Judges Royce Lamberth[62] and Stanley Sporkin.[63] Professionals' responsibility for the destruction of our financial institutions cannot be ignored and it highlights the intellectual bankruptcy of their demands for immunity.[64] Such wrongdoing is not a recent

[62] Enforcing a subpoena issued by the Office of Thrift Supervision (OTS), which sought to compel Ernst & Young to turn over documents relating to its audit and accounting work on behalf of 23 failed thrift institutions, Judge Lamberth wrote that "[a]ccounting firms may have been responsible for many of the abuses which have led to this country's savings and loan crisis. In fact, OTS advised the court that approximately one-third of the 690 financial institutions that have failed were audited by Ernst & Young or its predecessor." *Director of OTS v. Ernst & Young*, 786 F. Supp. 46, 52 (D.D.C. 1992).

[63] Judge Sporkin highlighted the role played by professionals who aided and abetted the fraudulent operation of Keating's ACC/Lincoln enterprise:

> Keating testified that he was so bent on doing the "right thing" that he surrounded himself with literally scores of accountants and lawyers to make sure all the transactions were legal. . . .
>
> Where were these professionals, a number of whom are now asserting their rights under the Fifth Amendment, when these clearly improper transactions were being consummated?
>
> Why didn't any of them speak up or disassociate themselves from the transactions?
>
> Where also were the outside accountants and attorneys when these transactions were effectuated?

Lincoln Sav. & Loan Ass'n v. Wall, 743 F. Supp. 901, 919-20 (D.D.C. 1990).

[64] *See* Note, *Are the Accountants Liable? Auditor Liability in the Savings and Loan Crisis*, 25 Ind. L. Rev. 475, 486 (1991) (observing that from the beginning of the thrift crisis, some institutions were given "clean" audit opinions only to be declared insolvent shortly thereafter); France, *Savings & Loan Lawyers*, 77 A.B.A.J. 52 (May 1991) (critical roles were often played by attorneys who aided and abetted thrift institutions' criminal wrongdoing); McCoy, Schmit & Bailey, *Hall of Shame: Besides S&L Owners, Host of Professionals Paved Way in Crisis*, Wall St. J., Nov. 2, 1990, at A1, col. 1; Wayne, *Where Were the Accountants?*, N.Y. Times, Mar. 12, 1989, § 3, at 1, col. 2 (detailing accounting firms' intimate involvement with numerous fraudulent thrifts).

phenomenon,[65] but attorneys' and accountants' current willingness to sacrifice ethics is well illustrated by *ACC/Lincoln*. In that case, elderly bondholders who had been left destitute by the bankruptcy of Keating's ACC holding company and regulatory seizure of Lincoln sued accountants, lawyers and consultants whose professional services aided and abetted his criminal scheme. Three "national" law firms – Kaye Scholer,[66] Sidley &

[65] *See United States v. Benjamin*, 328 F.2d 854, 863 (2d Cir.) (Friendly, J.) (affirming convictions of lawyers and accountants for conspiracy to violate securities laws: "In our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar."), *cert. denied*, 377 U.S. 953 (1964).

[66] Kaye Scholer, ACC/Lincoln Savings' principal outside counsel, instigated and aided and abetted Keating's fraudulent scheme to mislead investors by assisting in preparation of a misleading securities prospectus. The law firm "knowingly assisted" Keating and his confederates to make ACC bonds appear safe to the investing public, assisted in forging documents to cover Lincoln's unsafe practices and lent "credibility" to unsound securities by permitting the use of the Kaye Scholer name in connection with the offering. Although it characterized investors' claims as "frivolous" when they were filed, just one year later Kaye Scholer paid $20 million to settle those claims. *See Law Firm in Lincoln S&L Suit Agrees to Pay $20 Million*, S.F. Chron., June 16, 1990, at A1; *see also* Note, *Securities Attorneys Face Liability For Wrongs of Their Corporate Clients*, 5 J. of Legal Comment. 403, 406-08 (1990) (detailing Kaye Scholer's involvement in Keating's multi-faceted fraudulent schemes). Two years later, Kaye Scholer agreed to pay $41 million to settle Government accusations that it had improperly withheld damaging

Austin[67] and Jones, Day, Reavis & Pogue[68] – paid $87 million to settle defrauded investors' claims. Bondholders also received $103 million in settlements from accountants Arthur Young,[69] Arthur

information about Lincoln from federal regulators conducting a 1986 exam of the thrift. *See* A. Stevens & P. Thomas, *How a Big Law Firm Was Brought to Knees By Zealous Regulators*, Wall St. J., Mar. 13, 1992, at A1, col. 8.

[67] Sidley & Austin, which fended off federal regulators' attempts to close Lincoln in 1987-1988 through misrepresentations and threats of personal liability upon federal regulators, and which also termed investors' lawsuits meritless and frivolous when they were filed, paid $34 million to settle those claims. *See* J. Granelli, *Getting Their Day in Court*, L.A. Times, Mar. 1, 1992, at D-1.

[68] Jones Day, which agreed with Keating that it could "bill liberally" for legal services rendered in exchange for making political contributions at his direction, paid $23 million to settle investors' claims. *See* Cox, *Just Why Did Jones Day Settle?*, Nat'l L.J., Apr. 13, 1992, at 1. Jones Day also paid $51 million to settle RTC claims in connection with the law firm's work for Lincoln during a 1986 regulatory exam. *See* Jensen, *Jones Day: Behind the Settlement*, Nat'l L. J., July 5, 1993, at 1. During the exam, Jones Day lawyers laboring at Lincoln shrouded their work – and even their presence – in unusual secrecy; William Schilling, the Jones Day attorney in charge of determining whether the thrift was in regulatory compliance had months earlier been a federal regulator when he had received a memorandum detailing Lincoln's potentially disastrous condition; despite finding serious problems in the thrift's files – and by its own description being "shunted aside" for its blunt warnings – Jones Day not only failed to warn Lincoln's board of directors of the problems but also continued to be eager to accept other legal work from Keating. *Id.* at 32; *see also ACC/Lincoln*, 794 F. Supp. at 1449-54 (detailing law firm's willful involvement in scheme).

[69] Arthur Young (AY) partner Jack Atchison wrote advocacy letters to numerous U.S. Senators certifying Lincoln's financial condition and helped Keating convince several Senators (the "Keating Five") to intervene with federal regulators, as

Andersen[70] and Touche Ross,[71] demonstrating their willful involvement in the fraudulent scheme.

well as misrepresenting Lincoln's collapsing financial condition. The resulting two-year delay before regulators could seize Lincoln cost the taxpayers an additional $1 billion. Immediately after AY issued its year-end 1987 "clean" audit opinion certifying ACC/Lincoln's financial condition, Atchison resigned from the accounting firm and accepted a job from Keating paying over $700,000 per year – four times his partnership compensation at AY. *See* Jackson, *New Disclosures of Riegle's Lincoln Role Suggest He Was More Than a Bystander*, Wall St. J., Nov. 15, 1989, at A28, col. 1; Jackson, *FBI Probe Focuses on Senators' Ties to Keating's S&L*, Wall St. J., Nov. 13, 1989, at A7B, col. 2. Ernst & Young (AY's successor) agreed to pay $400 million to settle Government claims arising out of audits of seven thrifts, including Lincoln. *See* K. Bacon & L. Berton, *Ernst to Pay $400 Million Over Audit of Four Big Thrifts*, Wall St. J., Nov. 24, 1992, at A3, col. 1.

[70] Arthur Andersen (AA) received $3.7 million for providing clean audit opinions to ACC/Lincoln in 1984 and 1985. According to regulators, it fraudulently backdated loan file data and "stuffed" files with loan documentation. *See* Thomas, *Regulators Cite Delays and Phone Bugs in Examination, Seizure of Lincoln S&L*, Wall St. J., Oct. 27, 1989, at A4, col. 2; Granelli, *Keating Trial Focuses on Advisers*, L.A. Times, Mar. 14, 1992, at D1, col. 3. AA agreed to pay $30 million to settle claims asserted by stockholders and bondholders after agreeing to pay $25 million to settle claims brought by the RTC. *See* Jefferson & Berton, *Accounting Firm to Settle Suit on Thrift*, Wall St. J., Mar. 17, 1992, at A4, col. 1.

[71] Touche Ross improperly accepted the ACC/Lincoln engagement after AA and AY resigned and it misled federal regulators concerning the status of the 1988 audit, thereby delaying regulatory seizure of the thrift and permitting Keating to sell millions of dollars of worthless bonds to elderly investors. *See ACC/Lincoln*, 794 F. Supp. at 1441-47. Its successor (Deloitte & Touche) paid $9 million to settle bondholders' claims four days before they were submitted to the jury (*see* note 49, *supra*).

As these scandals demonstrate, accountants continue to ignore their roles as public watchdogs, *see United States v. Arthur Young & Co.*, 465 U.S. 805, 817-18 (1984), and they mislead this Court by contending that the specter of aiding and abetting liability has devastated their financial capability.[72] They improperly seek absolution from liability under § 10(b)/Rule 10b-5. Neither public policies underlying the federal securities laws, nor the laws themselves, should be subverted to provide errant professionals with such relief.

III. CONCLUSION

For the reasons stated above, the decision of the court below should be affirmed.

DATED: September 10, 1993

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[72] *See* Brief of AICPA as *Amicus Curiae* at 2, 17-19. The accounting profession argues that without liability reform, cases brought against auditing firms could wipe out their capital and insurance, expose partners' personal assets to seizure and drive them into bankruptcy. Although they claim that 1991 revenue for the Big Six was a mere $5.3 billion, this figure includes only their accounting and auditing work; in fact, revenue for the Big Six in 1991, the most recent year available, was over $29 billion. *See Int'l Accounting Data Book* (Lafferty Business Research 1992). In that year, legal fees and judgments were only 1.6% of revenue, rather than the 9.1% reported by the AICPA, and only 17% of the claims on the AICPA's liability insurance plans arises from audits, compared to 40% from tax-related services. *See Most Common Causes of Claims in AICPA Liability Insurance*, Accounting Today, July 20, 1992, at 2. When they are not pleading for relief from liability, accounting firms publicly boast that the cash flow from legal settlements has had little effect on their income. *See* S. Labaton, *$400 Million Bargain for Ernst*, N.Y. Times, Nov. 25, 1992, at C1; C. Harlan, *Coopers & Lybrand Agrees to Payment of $95 Million in the MiniScribe Case*, Wall St. J., Oct. 30, 1992, at C1.